GSG Gorfine Schiller Gardyn
Certified Public Accountants and Consultants

Business Owner's Perspectives
FALL 2020

IN THIS ISSUE:

New Benefit Plan Auditing Standards Effective Next Year

In 2017, the AICPA issued an exposure draft of new standards designed to overhaul employee benefit plan audits. The standards, originally scheduled to go into effect at the end of 2020 but delayed by the pandemic, will now go into effect for audits of financial statements for plans with years ending December 31, 2021. The standards cover financial statement audits for employee benefit plan audits subject to the Employee Retirement Income Security Act of 1974 (ERISA), which are generally plans with more than 120 eligible participants.

Why Now?

The updated standards were prompted in part by a 2015 U.S. Department of Labor report that found that 39 percent of employee benefit plan audits contained "major deficiencies with respect to one or more Generally Accepted Auditing Standards (GAAS) requirements which would lead to rejection of a Form 5500 filing, putting $653 billion and 22.5 million plan participants and beneficiaries at risk."

Since then, the AICPA has been working on solutions to improve the quality of employee benefit audits and enhance the value of audit reports for users. The resulting final standard, Statement on Auditing Standards (SAS) Number 136, "Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA," includes several significant changes.

What's New?

According to the AICPA, the standard provides new requirements in all audit phases, including engagement acceptance, risk assessment and response, communication with those charged with governance, performance procedures, and reporting.

Among the changes are new rules related to limited-scope audits, now referred to as ERISA section 103(a)(3)(c) audits, and the reports issued by auditors in this type of engagement.

The standards also require new management representations regarding maintaining a current plan instrument, administering the plan, and providing the auditor with a substantially complete draft Form 5500 prior to the dating of the auditor's report.

Plan administrators who choose this type of audit must now acknowledge their responsibilities in seeking and reviewing investment certifications and confirming that the certifying institution is qualified. Administrators must also notify management that the certification is proper.

The new standards also clarify auditor expectations, including procedures to be used when performing this type of audit—specifically on certified investment information—and describe a new type of report that provides greater transparency for users. After the audit is complete, auditors will use a new reporting model with longer, more detailed financial statement opinions that clearly state the scope and nature of the engagement, indicating what the auditors did and did not include in their analysis.

Rather than including a disclaimer of opinion for certified investment information, auditors will offer an opinion about the fair presentation of information not covered by the certification and address the relationship between certified investment information and financial statements. Findings will also be more detailed, which will help plan managers correct them, if needed.

How Can You Prepare?

Note that the new SAS doesn't change ERISA rules, so management can still select an ERISA section 103(a)(3)(c) audit. And while the new SAS doesn't include any particularly significant new responsibilities for plan sponsors, there are additional steps and procedures your administrators and auditing team must complete. For this reason, working with a highly experienced and qualified team of auditors is imperative.

In addition, good communication among all parties will support a smooth transition to the new standards and set you up for success with your audit next year.

Five Lessons Learned About Disaster Planning

If the pandemic has taught business owners anything, it's that anything can happen. Who'd have thought that our country, our economy, and our businesses would be dealing with a deadly global health crisis for the better part of a year? Who'd have predicted that all the brainstorming and second-guessing that went into carefully crafted disaster plans wouldn't remotely accommodate what companies have been facing over the past months?

However, business owners have learned important lessons for preparing for the unexpected. Here are five takeaways to discuss with your team:

1. Practice. Theoretical plans work on paper. It's smart to try them in a working setting to see how they perform in the real world.

As you update your plans for the coming year, set aside time for a trial run. This will illuminate issues with technology, people, weather, vendors, and other variables that affect your plan. Include select suppliers and customers so you can accommodate their connections, schedules, and must-haves.

2. Improvise. One of the most powerful lessons of the pandemic is that even with practice (see above!), the best-laid plans don't always work. Improvisation is essential.

Nimble companies adjust on the fly. During the pandemic, agile organizations regrouped and moved ahead. On the contrary, inflexible companies were unable to adjust to the new pandemic paradigm, resulting in frustration and lost opportunities.

What have been the sticky parts of your pandemic performance? Have your teams been able to adjust? Are individuals empowered to keep work moving as efficiently as possible? How can you encourage out-of-the-box thinking and improvisation?

3. Talk. For much of 2020, things changed quickly, and it was hard to keep up. Initially, there were seemingly never-ending video conference meetings to discuss workflow and processes, resulting in virtual meeting fatigue. At that point, communication stalled, and it was harder to find time to brainstorm and try new ideas.

Moving forward, it's imperative to include more casual gatherings to exchange ideas. Even a virtual break room or lunch-and-learn is helpful to foster interaction. Much is lost when there's no opportunity to simply catch up and have a friendly conversation.

4. Evaluate. Today's robust data analytics has taught us that an "experiment, test, evaluate, and change" attitude keeps work fresh. Constant evaluation—without blame, shame, or judgment—is the key to flexibility. Keep what's working. Let go of what's not. Quick surveys, or even informal check-ins with customers, are a good way to gather information. Showing concern and curiosity about your performance keeps customers engaged and opens the door to more feedback.

5. Reevaluate, Later. Time provides perspective. After a crisis, gather the team for a discussion of what to do better next time. It's likely that new solutions and different approaches—maybe even a complete reorganization—will bubble up. There's no doubt that your company will come out of every challenge with new ideas for next steps.

Remember, there is no one-size-fits-all planning for disasters, whether a "traditional" one like a flood or fire or a novel one like the coronavirus. Whether your path has been smooth or difficult, celebrate what you did right and address what you can do better next time. Disaster plans must always be updated because there are always lessons to learn.

A Look at ESOPs

If the pandemic has inspired you to think about exit planning, consider adding an employee stock ownership plan (ESOP) to your list of options.

An ESOP is a tax-qualified contribution retirement plan that gives employees ownership in the company. According to the National Center for Employee Ownership, there are about 6,500 ESOPs in the United States, holding assets of more than $1.4 trillion and covering more than 14 million participants.

ESOPs can work for companies in a variety of industries. Among the largest companies with these plans are Publix Super Markets, electrical equipment wholesaler Graybar, and architecture firm Gensler. Fashion entrepreneur Eileen Fisher owns about 60 percent of her eponymous design firm, but her 1,200 full- and part-time employees own the remaining 40 percent through an ESOP.

On the Plus Side…

For business owners, creating an ESOP delivers several benefits, including:

Control: For owners who aren't quite ready to go, this type of plan may allow for ownership transition over time. The owner can keep control and remain actively involved in the company.

Liquidity: An ESOP provides owners with a market for their shares of the company, which allows them to sell to employees without requiring the employees to come up with cash to buy the business.

Legacy: With an ESOP in place, the business will continue after the owner leaves. The owner also avoids the pain of having to sell to a competitor or third party.

Tax deduction: Annual stock or cash contributions to an ESOP are tax-deductible to the employer. If the ESOP borrows to buy new or existing shares, the company's contributions to repay the loan are also deductible.

Motivation: Employee owners tend to act more like owners than employees. With some skin in the game, they are motivated to work harder, care more about profitability, and focus more on customer service.

As for the Minuses…

ESOPS are not right for every owner, company, or situation. There are several potential downsides, including:

Costs: Ongoing costs almost always top the list of disadvantages. They incur third-party administration, valuation, and legal expenses. If these expenses aren't feasible given your company's cash flow, an ESOP may not be a good choice for you at this time.

Price: Selling to an ESOP is not likely to maximize the price. While the price will likely be competitive, especially given the benefits mentioned previously, it will not include the premium that would be paid by a strategic buyer.

Management: Selling to an iffy management team can undo the benefits a retiring owner is seeking. If you are considering an ESOP, getting a great management team in place is a must. Similarly, the corporate culture—and the owner— must be supportive of a shared management style.

Size: ESOPs generally don't work well in companies with fewer than 20 employees.

Carefully consider the pros and cons of an ESOP to see if one might be a good fit for your company.

Good Governance: A Must for Family Businesses

For family business owners, mixing family and business has its benefits: shared goals, trustworthy employees, and control over the family legacy.

But it can be difficult to separate the family from the business. Which takes priority? How do you decide what's best for each entity?

Robust family and business governance policies can facilitate decision making.

Harvard Business School's Renato Tagiuri and John Davis describe a three-circle framework for family business governance: ownership, family, and business. Each circle has its own governance needs—but the most challenging is often the family itself.

The scholars' family governance model includes three components: a family assembly, a family council, and a family constitution.

Together, these elements can help the family agree upon roles, encourage members to act responsibly, and regulate appropriate family ownership and work in the business.

Family Assembly

The family assembly is an annual family meeting for all adult family members. The purpose is to discuss the direction of the company, provide education about the company's business, and give updates on important events, such as changes in ownership.

Family Council

If a family is larger than 15 people, a smaller family council can be responsible for developing plans and policies that regulate family activities with the business. The council should represent all generations and branches of the family.

Family Constitution

This document, created by the family council, articulates the family's vision and values and outlines important policies for the family business.

For example, it covers employment standards, career development, compensation, succession, ownership, and dividends for family members.

Having these elements in place eliminates uncertainty about expectations for behavior, education, and compensation. The result? A family business that operates efficiently.